

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
STATEMENT PRESENTED TO
INTERNAL REVENUE SERVICE OVERSIGHT BOARD
PUBLIC MEETING**

February 28, 2012

The American Institute of Certified Public Accountants thanks the IRS Oversight Board for the opportunity to appear before it today. I am Patricia Thompson, Chair of the AICPA's Tax Executive Committee; and a partner with Piccerelli, Gilstein & Company, LLP, located in Providence, Rhode Island.

The AICPA is the national professional association of certified public accountants comprised of approximately 377,000 members. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We agree with the IRS Oversight Board's central premise underlying the panel discussions for today's meeting which is the "IRS will face significant challenges as it grapples with limited budgets and the need to constantly do more with less." In this context, I am pleased to participate on today's panel on how correspondence examinations (or audits) can be more effective for the IRS and less burdensome for taxpayers. We recognize that correspondence examinations may be cost efficient for the Service; and as for the taxpayer, he or she may potentially find a correspondence examination as less time consuming and less expensive when compared to the traditional IRS examination involving an office visit. Our remarks are supportive of this premise, and we are pleased to make suggestions regarding how the Service can make correspondence examinations more effective and, at the same time, less burdensome to taxpayers.

The IRS Budget

While we have framed our remarks on correspondence examinations around an IRS budget involving scarce resources, we emphasize our strong support for full funding of the Internal Revenue Service's fiscal year 2013 budget. We note that in late 2011, Congress approved a continuing resolution which effectively set the IRS budget at \$11.8 billion for fiscal year 2012, a cut of approximately \$306 million from fiscal year 2011.

We have long advocated funding levels for the IRS which would allow the Service to efficiently and effectively administer the tax laws and collect taxes. Giving the Service the resources necessary to properly process tax returns and enforce the tax laws is vital to maintaining our voluntary compliance tax system.

We expect the Service to identify responsible ways to allocate any additional resources it receives; and that Congress, through its oversight responsibilities, will ensure that those resources are properly utilized. Unfortunately, the budget process has become much more complicated for federal agencies in general and especially challenging for the IRS. In this context, National Taxpayer Advocate Nina Olson recently stated that the most serious challenge facing American taxpayers is the combination of the IRS's expanding workload and the agency's limited resources to handle that workload. Ms. Olson points out that the Service's role has expanded from one concentrated on tax collection to one focused on distributing benefits to a variety of individuals and businesses.¹

The AICPA believes that the Service should be provided with the proper resources to fund its mission, which will in turn empower the Service to fulfill its customer service and enforcement responsibilities. Any increase in enforcement funding must be balanced with positive responses to the taxpaying public as customers, a balancing act which has become even more challenging for the Service when faced with the current era of "mission creep" beyond its core tax administration functions. As we have stated in the past, all taxpayers must have access to resources that enable them to fulfill their responsibilities, and budgetary funding must be provided to ensure this access.

How Can Correspondence Examinations Be Made More Effective for the IRS and Less Burdensome for Taxpayers?

AICPA members are very familiar with the difficulties and challenges taxpayers have faced over the last several years with correspondence examinations. Despite these difficulties, we recognize why the IRS so heavily relies on correspondence examinations as the "work horse" for its overall examination program. According to the IRS Oversight Board, correspondence examinations have grown from 72 percent of all IRS examinations in fiscal year 2001 to 78 percent in fiscal year 2010.² Of further significance, these statistics are even more startling when taking into account that correspondence audits amounted to 54 percent of all examinations in fiscal year 2000.³

This trend will continue to increase because correspondence audits are less labor intensive, more computerized or automated and thus, perceived as more cost efficient as compared to other types of examinations. However, it is the increase in the computerization and mechanization of the correspondence audit program which triggers taxpayer concerns and problems with the program. According to a 2009 report by National Taxpayer Advocate Nina Olson, "IRS employees spent an average of only 1.6 hours in 'direct time' on each correspondence examination in FY 2008, as compared to 8.5 hours on each office examination, and 46.4 hours on each field examination."⁴

The AICPA is supportive of the IRS Oversight Board's goals of ensuring that the correspondence audit program becomes both a beneficial compliance tool and resource efficient

¹ National Taxpayer Advocate 2011 Annual Report to Congress, December 31, 2011, Volume One, page 3. See footnote on page 3 for examples of recently enacted legislation providing social benefits to taxpayers.

² IRS Oversight Board letter, dated January 11, 2012, to Edward Karl, AICPA Vice President-Taxation.

³ National Taxpayer Advocate 2009 Annual Report to Congress, December 31, 2009, Volume 1, page 158.

⁴ Ibid, page 158.

for the Service. We are also supportive of limited focus examinations like correspondence examinations to the extent the program reduces burden on taxpayers, which is a stated goal of the Oversight Board.

1. Recommendations to Improve the Correspondence Examination Program

The AICPA has communicated with the IRS on a number of occasions in recent years about the problems taxpayers have faced with correspondence examinations. Our members have raised concerns about: (1) the excessive time it takes the IRS to resolve a taxpayer's case; (2) the great difficulties taxpayers face when trying to contact the IRS to obtain information regarding the status of their correspondence audit case; (3) the numerous telephone inquiry calls taxpayers or their tax representative make to the IRS which go unreturned; and (4) the IRS employees routinely closing cases and issuing the statutory notice of deficiency (i.e., the "90 day letter") without having reviewed correspondence submitted by the taxpayer.

We have recommended for the Service to improve their telephone assistance lines to enable taxpayers to speak directly with an IRS staff person about their correspondence audit case. Further, we have also strongly urged the Service to address taxpayer problems related to IRS personnel closing cases and issuing "90 day letters" too hastily. On this latter issue, we have received informal feedback from our CPA members that while the Service appears to be still taking an excessive amount of time to close taxpayer cases, the IRS is doing a much better job of holding off on hastily issuing "90 day letters." Unfortunately, the AICPA cannot confirm whether this latter "improvement" in the correspondence audit process is more due to the fact that the taxpayer is represented by a tax professional as opposed to those situations where the taxpayer is self-represented.

2. Situations Where Correspondence Examinations May Fail to Detect Significant Noncompliance Or May Result in Inaccurate Adjustments Against Taxpayers

Correspondence audits are much less labor intensive, and more computerized as compared with other types of examinations.⁵ In general, in a correspondence examination the IRS mails a letter to the taxpayer, asking him or her to address a few limited issues on the tax return, often focusing on credit or deduction issues. We continue to be supportive of the limited issue focus approach to the correspondence audit program.

National Taxpayer Advocate Nina Olson in her 2009 report to Congress states that while correspondence audits may provide the IRS with increased audit coverage, the increased coverage may come at the expense of quality and may lead to "reduced voluntary compliance if taxpayers conclude that...[a correspondence] examination will not detect tax cheating, or that the audit process is arbitrary or unfair."⁶

⁵ See Treasury Inspector General for Tax Administration Report on "Progress Has Been Made to Re-engineer the Examination Program, but Additional Improvements Are Needed to Reduce Taxpayer Burden, February 18, 2011, Reference Number 2011-30-016, page 1

⁶ National Taxpayer Advocate 2009 Annual Report to Congress, op. cit, page 159.

We recommend that the IRS conduct an internal review regarding whether the Service is pulling the correct types of returns for examination under its correspondence audit program. Further, the AICPA could be supportive of a correspondence audit program in the future which strives to increase the number of tax compliance issues covered by a correspondence examination; that is, coverage beyond the current limited issue nature of such examinations. For example, this could be accomplished by the IRS implementing more effective filters to detect non-compliance for Form 1040, Schedule C filers at the same time the Service is attempting to detect non-compliance by the same taxpayer for items involving his or her Form 1040, Schedule A. However, we firmly believe that before the IRS attempts to expand the correspondence examination program beyond its current limited issue focus, the IRS should address the documented deficiencies that exist with its current program. Our comments have described such deficiencies above. We believe that addressing these deficiencies is the best way to increase taxpayer confidence in federal tax administration and have the result that taxpayers believe they have been treated fairly by the process.

3. IRS Efforts to Streamline Its Incoming Mail Processing

IRS delays -- in the posting or proper handling of correspondence mailed by a taxpayer to the Service -- is a major concern of CPAs about the correspondence examination program. This is consistent with a 2011 report of the Treasury Inspector General for Tax Administration (TIGTA). According to the report, the IRS indicated to the IRS Oversight Board in 2009 that it would target three areas for improvements regarding its correspondence audit program, including mail processing.⁷ The TIGTA report discusses a “judgmental sample” of 24 default cases after receiving concerns that IRS employees were not following proper procedures in handling taxpayer correspondence. In 17 of these cases, it was concluded that IRS staff did not consider the taxpayers’ correspondence prior to closure of the cases. Moreover, in 10 of these 17 cases, the taxpayers’ correspondence was not input into the IRS’s computer system within the required time period, resulting in the Service employees involved with the correspondence audit program not being aware that correspondence had been received prior to closure of the cases.

The 2011 TIGTA report mentions that the Wage & Investment Division (W&I) began piloting a centralized model for processing incoming mail at the Austin Compliance Site in February 2010. This pilot provided for the centralization of all mail processing and it included flexibility in planning and staffing. The TIGTA report states that the IRS planned on implementing this model at all W&I and Small Business/Self-Employed compliance sites by June 2011.

While we are aware of (and concerned about) the problems associated with the IRS’s handling of correspondence in TIGTA’s judgmental sampling of the 24 cases described above, we would encourage the IRS Oversight Board to seek updated information from the Service regarding how these new centralized mail processing procedures are presently working. Unfortunately, based on informal discussions with our CPA members, CPAs are not currently noticing any discernible improvements in the handling of taxpayer correspondence mailed to the IRS in response to a correspondence examination. Thus, to the extent problems continue with mail processing, even

⁷ The other two areas that the IRS indicated in 2009 for improvements in correspondence audits included: (1) requests for taxpayer information documents; and (2) telephone access and service. See TIGTA report dated February 18, 2011, op. cit., page 2.

with these new centralized procedures in place, we recommend that the managers of IRS employees become more involved with resolving issues with respect to correspondence audit cases more than 6 months old.

4. IRS Handling of the CADE 2 System

In January 2012, the IRS implemented the first phase of its Customer Account Data Engine (CADE 2); a program which if working effectively, will enable the IRS to provide taxpayers with faster refunds, as well as quicker account updates and transaction processing. Unfortunately, tax professionals and the taxpaying public will need to take a “wait and see” approach to CADE 2 given the difficulties the Service has faced with the implementation of proposed technology enhancements over the last two decades or more.

If the IRS is successful with CADE 2, it could prove helpful to taxpayers in terms of ensuring faster account resolution. However, we do not have any information at this time as to how CADE 2 might enable the IRS to improve its processing of taxpayer correspondence submitted in response to a correspondence audit. In term of faster account resolution, we recommend for the Service to explore the potential for expanding its e-Services suite of web-based products to handle correspondence submitted by a tax professional on a taxpayer’s behalf. Currently, certain tax professionals with proper authorization may use e-Services for disclosure authorization, electronic account resolution, and transcript delivery. If e-Services could be expanded to effectively act as a “portal” for correspondence submitted on the taxpayer’s behalf, we believe significant opportunities might be created for resolving correspondence examinations more timely, including the prospects that the correspondence submitted through e-Services might be electronically date-stamped as to its submission date.

On the issue of utilizing the correspondence audit process to address the merchant (credit and debit) card reporting initiative for business returns and stock basis reporting, we urge caution. First, as a partial acknowledgement of the potential reporting complexities associated with merchant card reporting, the IRS recently added a frequently asked question (FAQ) to irs.gov which generally states that businesses will not be required to reconcile the gross receipts reported on Forms 1099-K on their tax returns.⁸ Second, we believe stock basis reporting will likely (for at least the first several years) prove very challenging for taxpayers both from a “taxpayer burden” and reconciliation perspective. We do not view the stock basis reporting program as particularly conducive to producing satisfactory resolutions within the context of the correspondence audit program, especially when correspondence examinations traditionally require taxpayers to respond to IRS inquiries on very tight/short deadlines coupled with a need to provide relatively straight-forward explanations about apparent account discrepancies.

⁸ See the FAQ at irs.gov which states “I received a 1099-K for 2011. How do I report it on my tax return this year and what are the plans for reporting in 2012?” This FAQ can be found at the following URL: <http://www.irs.gov/newsroom/article/0,,id=253979,00.html#q1>

5. Correspondence Examinations and Taxpayer Rights

TIGTA has released a number of reports raising concerns about the correspondence examination program and taxpayer burden, including its February 2011 report on “Progress Has Been Made to Re-engineer the Examination Program, but Additional Improvements Are Needed to Reduce Taxpayer Burden.”⁹ Similarly, National Taxpayer Advocate Nina Olson in her 2011 report to Congress raises significant concerns about the IRS’s ability to respond to telephone calls and correspondence from taxpayers.¹⁰

The AICPA supports TIGTA’s and the National Taxpayer Advocate’s concerns about the linkage between improving taxpayer service and the ability of the Service to properly address taxpayer rights. We believe the IRS has made positive strides by improving its telephone customer service lines and the handling of taxpayer correspondence, but obviously further improvements are warranted.

As part of a correspondence examination, taxpayers are often requested to substantiate specific tax deductions like miscellaneous itemized deductions, state and local income taxes, and real estate taxes. However, it appears that the IRS may be making this substantiation request to a large number of taxpayers who happen to be in an alternative minimum tax position, with these types of deductions having no impact on the taxpayer’s ultimate tax liability. The net result is a “no-change” audit for the taxpayer and a waste of resources for the IRS. We suggest that the IRS create an additional “filter” for its correspondence audit selection process to remove these types of cases from the Service’s active case file.

We stand ready to assist the IRS by providing input on ways the Service might make further improvements in these areas in general and with respect to the correspondence examination program specifically.

⁹ TIGTA report dated February 18, 2011, op. cit.

¹⁰ National Taxpayer Advocate 2011 Annual Report to Congress, December 31, 2011, Volume One, op. cit., page 9.